# INDIAN ECONOMY





## INTRODUCTION-ECONOMY

- The term economy has been defined by A. J. Brown as, "A system by which people earn their living." J. R. Hicks defined as, "An economy is a cooperation of producers and workers to make goods and services that satisfy the wants of the consumers."
- The subject Economics is classified into two branches, namely, Micro Economics and Macro Economics.
- The terms 'micro economics' and 'macro economics' were first used in economics by Norwegian economist **Ragner Frisch** in 1933
- John Maynard Keynes is considered the father of macroeconomics

**Macro-economics**

- The branch of economics that studies the behavior and performance of an economy as a whole
- It is the study of aggregates such as national output, inflation, unemployment and taxes
- **The General Theory of Employment, Interest and Money** published by Keynes is the basis of modern macro-economics.

**Micro-economics**

- Micro Economics is the study of the economic actions of individual units say households, firms or industries.

## Economic System

- Economic System refers to the manner in which individuals and institutions are connected together to carry out economic activities in a particular area. It is the methodology of doing economic activities to meet the needs of the society
- There are three major types of economic systems. They are:
  1. Capitalistic Economy
  2. Socialistic Economy
  3. Mixed Economy



## Capitalistic Economy

- Adam Smith is the ‘Father of Capitalism’.
- Capitalistic economy is also termed as a free economy or market economy where the role of the government is minimum and market determines the economic activities.
- The means of production in a capitalistic economy are privately owned. Manufacturers produce goods and services with profit motive. The private individual has the freedom to undertake any occupation and develop any skill.
- The USA, Germany, Australia and Japan are the best examples for capitalistic economies

## Socialistic Economy

- The Father of Socialism is Karl Marx.
- Socialism is defined as a way of organizing a society in which major industries are owned and controlled by the government, A Socialistic economy is also known as ‘Planned Economy’ or ‘Command Economy’
- In a socialistic economy, all the resources are owned and operated by the government. Public welfare is the main motive behind all economic activities

- It aims at equality in the distribution of income and wealth and equal opportunity for all
- China, Vietnam, Poland and Cuba are the examples of socialist economies. But, now there are no absolutely socialist economies.

### Mixed Economy

- In a mixed economy system both private and public sectors co-exist and work together towards economic development
- In these economies, resources are owned by individuals and the government.
- Examples of mixed economy: India, England, France and Brazil

## NATIONAL INCOME

- National Income provides a comprehensive measure of the economic activities of a nation. It denotes the country's purchasing power. The growth of an economy is measured by the rate at which its real national income grows over time.
- National income thus serves as an instrument of economic planning.
- National Income means '**The total money value of all final goods and services produced in a country during a particular period of time**'



### Basic concepts of national income

- The following are some of the concepts used in measuring national income.
    1. Gross Domestic Product (GDP)
    2. Net Domestic Product (NDP)
    3. Gross National Product (GNP)
    4. Net National Product (NNP)
    5. NNP at factor cost
    6. Personal Income
    7. Disposable Income
    8. Per capita Income
    9. Real Income

10. GDP deflator

## Gross Domestic Product (GDP)

- Gross Domestic Product (GDP) is the value of the all final goods and services produced within the boundary of a nation during a year period. For India, the financial year is from 1st April to 31st March.
- India's GDP is 3rd largest in the world in terms of purchasing power parity(PPP)

## Net Domestic Product (NDP)

- Net Domestic Product (NDP) is the GDP calculated after adjusting the weight of the value of 'depreciation'.

  **NDP = GDP – Depreciation.**
- NDP of an economy has to be always lower than its GDP for the same year

## Gross National Product (GNP)

- GNP is the total measure of the flow of final goods and services at market value resulting from current production in a country during a year, including net income from abroad
- The normal formula is **GNP = GDP + Income from Abroad**

  {(**Income from abroad**= Trade balance + Interest on External Loans+ Private Remittance)



  Private remittance= Inflows and outflows on account of private transfer

  Trade balance = Net outcome at the year end of the total import and export.

  Interest on external loans= balance of the inflow of interest payment – Outflow of interest payment}
- In India's case, it has always been negative (due to heavy outflows on account of trade deficits and interest payments on foreign loans). It means, the 'Income from Abroad' is subtracted from India's GDP to calculate its GNP.

  **GNP = GDP + (–Income from Abroad)**

  (India's GNP is always lower than its GDP)
- GNP at market prices means the gross value of final goods and services produced annually in a country plus net factor income from abroad

## Net National Product (NNP)

- Net National Product (NNP) of an economy is the GNP after deducting the loss due to 'depreciation'.

  **NNP = GNP – Depreciation**

  Or

**NNP = GDP + Income from Abroad – Depreciation.**

- This is the purest form of the income of a nation.

## NNP at Factor cost

- NNP refers to the market value of output. Whereas NNP at factor cost is the total of income payment made to factors of production. Thus from the money value of NNP at market price, we deduct the amount of indirect taxes and add subsidies to arrive at the net national income at factor cost.

  **NNP at factor cost = NNP at Market prices – Indirect taxes + Subsidies.**

## Personal Income

- Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in a year

  Personal Income = National Income– (Social Security Contribution and undistributed corporate profits) + Transfer payments

## Disposable Income

- Disposable Income is also known as Disposable personal income. It is the individual's income after the payment of income tax

  **Disposable Income = Personal income – Direct Tax**



## Per Capita Income

- The average income of a person of a country in a particular year is called Per Capita Income. Per capita income is obtained by dividing national income by population

  **Per Capita income = National Income/ Population**

## Real Income

- Nominal income is national income expressed in terms of a general price level of a particular year in other words, real income is the buying power of nominal income.
- Real income is the income of individuals or nations after adjusting for inflation

## GDP deflator

- The GDP deflator is an index of price changes of goods and services included in GDP. It is a price index which is calculated by dividing the nominal GDP in a given year by the real GDP for the same year and multiplying it by 100.

GDP deflator = Nominal GDP/ Real GDP x 100

## Gross value added

- Gross value added (GVA) is the measure of the value of goods and services produced in an area, industry or sector of an economy.

  GVA = GDP + subsidies - (direct, sales) taxes.

## Cost and Price of National Income

### Cost

- **Factor cost**-The actual incurred on goods and services that are produced by the firms and industries in an economy is known as factor cost. i.e., cost of capital, interest on loans, raw materials, labour, rent, power, etc
- **Market cost-** 'Market cost' is derived after adding the indirect taxes to the factor cost of the product, it means the cost at which the goods reach the market
- India officially used to calculate its national income at factor cost. Since January 2015, the CSO has switched over to calculating national income at market cost. The market price is calculated by adding the product taxes to the factor cost



### Price

- Income can be derived at two prices, constant and current. The difference in the constant and current prices is only that of the impact of inflation

  Current prices= constant prices + inflation

## Purchasing Power Parity

- A concept related to purchasing power is Purchasing Price Parity (PPP). PPP is an economic theory that estimates the amount that needs to be adjusted to the price of an item
- PPP can be used to compare countries income levels and other relevant economic data concerning the cost of living, or possible rates of inflation and deflation.
- India is the third-largest economy in terms of Purchasing Price Parity (PPP)

# SECTORS OF THE ECONOMY

- Economic activities in a country/economy are broadly divided into three main sectors and by their dominant, economies get their names also

## Primary Sector

- The economic activities which take place while exploiting the natural resources fall under it, such as agricultural activities, mining, oil exploration, etc.
- When agriculture sector (sub-sectors of the primary sector) contribute minimum half of the national income and livelihood in a country it is called an agrarian economy.

## Secondary Sector

- It contains all of the economic activities under which the raw materials extracted out of the primary sector are processed (also called industrial sector).
- When secondary sector brings in minimum half of the national income and livelihood in a country it is called an industrial economy.



## Tertiary Sector:

- All of the economic activities where services are produced falls in this sector, such as education, healthcare, banking, communication, etc.
- When this sector contributes minimum half of the national income and livelihood in a country it is called a service economy.

## SECTORS OF THE INDIAN ECONOMY

- Indian economy is broadly divided into three sector
  1. **Primary Sector: (Agricultural Sector)** Agricultural sector is known as primary sector, in which agricultural operations are undertaken. Agriculture based allied activities, production of raw materials such as cattle farm, fishing, mining, forestry, corn, coal etc. are also undertaken.
  2. **Secondary Sector: (Industrial Sector)** Industrial sector is secondary sectors in which the goods and commodities are produced by transforming the raw materials. Important industries are Iron and Steel industry, cotton textile, Jute, Sugar, Cement, Paper, Petrochemical industry, automobile and other small scale industries.

3. **Tertiary Sector: (Service Sector)** Tertiary sector is known as service sector which includes Government, scientific research, transport communication, trade, postal and telegraph, Banking, Education, Entertainment, Healthcare and Information Technology etc.

## Contribution of different sectors in GDP of India

- India is 2nd largest producer of agricultural products. India accounts for 7.39 percent of total global agricultural output
- Indian GDP composition in currently is as follows: Agriculture (16.5%), Industry (29.01%) and Services (53.09%).
- The share of agriculture has been falling in the country's gross income, while industrial and services sectors' shares have been on a rise constantly. But from the livelihood point of view still 48.7 per cent of the people of India depend on the agriculture sector
- Sector share by working force: (Agriculture (48%): Tertiary (27%) : Secondary (24%))
- Contribution of Agriculture sector in Indian economy is much higher than world's average (6.4%). Contribution of Industry and Services sector is lower than world's average 30% for Industry sector and 63% for Services sector.
- India is the world's fifth-largest economy by nominal GDP and the third-largest by purchasing power parity (PPP).



## Agricultural Sector in India

- Agriculture being the maximum pursued occupation in India, it plays an important role in its economy as well.
- The share of agriculture has been falling in the country's gross income, while industrial and services sectors' shares have been on a rise constantly. But from the livelihood point of view still 48.7 per cent of the people of India depend on the agriculture sector. This makes agriculture is more important sector than the industry and the services
- Agriculture is the biggest unorganized sector of the economy accounting for more than 90 per cent share in the total unorganized labour-force (Over 94 percent of India's working population is part of the unorganized sector)
- India occupies a leading position in global agricultural trade having a share of 2.15 percent in the world agricultural trade

- Agriculture is not only the biggest sector of the economy, but also the biggest private sector of the country also.
- Green revolution, ever green revolution and inventions in bio technology have made agriculture self-sufficient and also surplus production
- Aimed at doubling the farmers' income by 2022, the Government of India has announced a 'seven-point strategy'. Details of the 'seven-point strategy' are as given below

  1. Focus on irrigation with bigger budgets aimed at 'per drop, more crop'.
  2. Provision of quality seeds and nutrients based on soil health.
  3. Strengthening warehousing and cold chains to prevent post-harvest crop losses.
  4. Promoting value addition through food processing.
  5. Creation of a national farm market, removing distortions and e-platform.
  6. Mitigating risks at affordable cost through suitable kind of farm insurance.
  7. Promoting ancillary activities like poultry, beekeeping and fisheries.



## RESERVE BANK OF INDIA

- The Reserve Bank of India was established on April 1, 1935, in accordance with the provisions of the Reserve Bank of India Act, 1934.
- The Central Office of the Reserve Bank was initially established in Kolkata but Headquarter moved from Calcutta to Mumbai in 1937
- Osborne Smith was the first Governor of Reserve Bank of India
- RBI was Nationalised on 1 January 1949

### Administration

- RBI has four zonal offices: New Delhi for North, Chennai for South, Kolkata for East, and Mumbai for West
- The Central Board consists of:
  - Governor
  - 4 Deputy Governors
  - 2 Finance Ministry representatives
  - 4 directors to represent local boards headquartered at Mumbai, Kolkata, Chennai, and New Delhi

- Governors and 4 Deputy Governors along with the central board of directors are appointed by the Government of India.
- The only Prime Minister who was the Governor of RBI was **Manmohan Singh**.
- The Reserve bank is referred to by the name 'Mint Street'.

## Functions of Reserve Bank of India

**Monetary Authority**

- It controls the supply of money in the economy to stabilize exchange rate, maintain healthy balance of payment, attain financial stability, control inflation, strengthen banking system

**The issuer of currency**

- The objective is to maintain the currency and credit system of the country. It is the sole authority to issue currency (Except the currency and coins of one rupee or its denominations, which are issued by Ministry of Finance). It also takes action to control the circulation of fake currency

**The issuer of Banking License**



- As per Section 22 of the Banking Regulation Act, 1949, every bank has to obtain a banking license from RBI to conduct banking business in India.

**Banker's Bank**

- RBI is the bank of all banks in India as it provides loan to banks, accept the deposit of banks, and rediscount the bills of banks.

**Banker to the Government**

- It acts as banker both to the central and the state governments. It provides short-term credit. It manages all new issues of government loans, servicing the government debt outstanding and nurturing the market for government securities.
- It advises the government on banking and financial subjects.

**Lender of last resort**

- The banks can borrow from the Reserve Bank of India by keeping eligible securities as collateral at the time of need or crisis, when there is no other source.

**Act as clearing house**

- For the settlement of banking transactions, RBI manages 14 clearing house. It facilitates the exchange of instruments and processing of payment instructions.

**Custodian of foreign exchange reserves**

- RBI acts as a custodian of FOREX. It administers and enforces the provision of Foreign Exchange Management Act (FEMA), 1999.
- RBI buys and sells foreign currency to maintain the exchange rate of Indian rupee v/s foreign currencies. Keeping the Forex (foreign exchange) reserves of the country
- RBI representing the Government of India in the IMF and World Bank (and other international financial agencies of which India is member).

**Regulator of Economy**

- It controls the money supply in the system, monitors different key indicators like GDP, Inflation, etc.

**Regulator and Supervisor of Payment and Settlement Systems**

- The Payment and Settlement Systems Act of 2007 (PSS Act) gives RBI oversight authority for the payment and settlement systems in the country.
- RBI focuses on the development and functioning of safe, secure and efficient payment and settlement mechanisms.
- The objective is maintaining public confidence in payment and settlement system.



**Banking Ombudsman Scheme**

- RBI introduced the Banking Ombudsman Scheme in 1995. Under this scheme, the complainants can file their complaints in any form, including online and can also appeal to the Ombudsman against the awards and the other decisions of the Banks.

**Publisher of monetary data and other data**

- RBI maintains and provides all essential banking and other economic data, formulating and critically evaluating the economic policies in India. RBI collects, collates and publishes data regularly

**Developmental Functions**

- This role includes the development of the quality banking system in India and ensuring that credit is available to the productive sectors of the economy .It provides a wide range of promotional functions to support national objectives..

- It also includes establishing institutions designed to build the country's financial infrastructure. Playing this role, RBI did set up developmental banks like—IDBI, SIDBI, NABARD, NEDB (North Eastern Development Bank), Exim Bank, NHB.

## Monetary Policy

- Monetary policy refers to the use of monetary instruments under the control of the central bank to regulate magnitudes such as interest rates, money supply and availability of credit with a view to achieving the ultimate objective of economic policy.
- Monetary Policy is the macroeconomic policy being laid down by the Central Bank towards the management of money supply and interest rate.
- It is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.
- There are several direct and indirect instruments that are used for implementing monetary policy. These are Cash Reserve Ratio, Statutory Liquidity Ratio, Bank Rate, Repo Rate, Reverse Repo Rate, and Open Market Operations.



- The Monetary Policy Committee (MPC) constituted by the Central Government under Section 45ZB determines the policy interest rate required to achieve the inflation target.
- The objectives of monetary policy are
  1. Neutrality of Money
  2. Stability of Exchange Rates
  3. Price Stability
  4. Full Employment
  5. Economic Growth
  6. Equilibrium in the Balance of Payments

## Credit Control Measures

- Credit control is the primary mechanism available to the Central banks to realize the objectives of monetary management
- The statutory basis for the control of the credit system by the Reserve Bank is embodied in the Reserve Bank of India Act, 1934 and the Banking Regulation Act, 1949.

## Methods of Credit Control

- General or Quantitative Methods
  1. Bank Rate 2. Open Market Operations 3. Variable Cash Reserve Ratio
- Selective or Qualitative Methods
  1. Rationing of Credit 2. Direct Action 3. Moral suasion 4. Publicity 5. Regulation of Consumer' Credit 6. Marginal Requirements

## Quantitative or General Methods

### 1. Bank Rate Policy

- The interest rate which the RBI charges on its long-term lendings is known as the Bank Rate.
- The rate has direct impact on long-term lending activities of the concerned lending bodies operating in the Indian financial system
- Example: If the Central Bank wants to control credit, it will raise the bank rate. As a result, the deposit rate and other lending rates in the money-market will go up. Borrowing will be discouraged, and will lead to contraction of credit and vice versa.



### 2. Open Market Operations

- **In narrow sense**, the Central Bank starts the purchase and sale of Government securities in the money market
- **In Broad Sense**, the Central Bank purchases and sells not only Government securities but also other proper eligible securities like bills and securities of private concerns. When the banks and the private individuals purchase these securities they have to make payments for these securities to the Central Bank.

### 3. Variable Reserve Ratio

**Cash Reserves Ratio**

- Variable Cash Reserve Ratio as an objective of monetary policy was first suggested by J.M. Keynes
- Cash reserve Ratio (CRR) is the amount of Cash that the banks have to keep with RBI
- The commercial banks as per the statute has to maintain reserves based on their demand deposit and fixed deposit with central bank is called as Cash Reserve Ratio
- If the CRR is high, the commercial bank's capacity to create credit will be less and if the CRR is low, the commercial bank's capacity to create credit will be high.

**Statutory Liquidity Ratio**

- Statutory Liquidity Ratio (SLR) is the amount which a bank has to maintain in the form of cash, gold or approved securities. The quantum is specified as some percentage of the total demand and time liabilities of a bank.
- SLR is used to control the bank's leverage for credit expansion.

## Repo Rate and Reverse Repo Rate

- The Repo Rate and the Reverse Repo Rate are the frequently used tools with which the RBI can control the availability and the supply of money in the economy. Repo Rate is always greater than Reverse Repo Rate in India

### Repo Rate

- Repo rate is the rate at which the central bank of a country lends money to commercial banks in the event of any shortfall of funds.
- Repo rate is used by monetary authorities to control inflation.

### Reverse Repo Rate



- The rate at which the RBI is willing to borrow from the commercial banks is called reverse repo rate
- The Reverse Repo Rate is an important Monetary Policy tool used by the Reserve Bank of India (RBI) to control money supply or liquidity and inflation in the economy.

## CALL MONEY MARKET:

- The call money market is an important segment of the money market where borrowing and lending of funds take place on over night basis
- Participants in the call money market are banks and related entities specified by the RBI, Participants in the call money market in India currently include scheduled commercial banks (SCBs) —excluding regional rural banks), cooperative banks (other than land development banks), Primary Dealers (PDs).
- The money that is lent for **one day** in this market is known as **call money** and, if it exceeds one day, is referred to as **notice money**. Notice Money refers to the borrowing and lending of funds for **2-14 days**

## NEW FINANCIAL YEAR OF RBI

- Aimed at aligning its financial year with the government's financial year, in February 2020, the RBI decided to shift to April- March as its new financial year from 2020-21 (from its existing financial year July-June).

# BANKING IN INDIA

## BANKING

- Banking sector acts as the backbone of modern business world. The banking system significantly contributes for the development of any country.
- The first bank of India was Bank of Hindustan (1770)

### Nationalisation of Banks

- After Independence, the Government of India adopted planned economic development. The main objective of the economic planning aimed at social welfare. Before Independence commercial banks were in the private sector. These commercial banks failed in helping the Government to achieve social objectives of planning. Therefore, the government decided to nationalize 14 major commercial banks on 19 July 1969. In 1980, again the government took over another 6 commercial banks.

### Objectives of Nationalisation

1. The main objective of nationalisation was to attain social welfare. Sectors such as agriculture, small and village industries were in need of funds for their expansion and further economic development.
2. Nationalisation of banks helped to curb private monopolies in order to ensure a smooth supply of credit to socially desirable sections
3. Banks created credit facilities mainly to the agriculture sector and its allied activities after nationalization.
4. Nationalisation of banks was required to reduce the regional imbalances where the banking facilities were not available



## COMMERCIAL BANKS

- Commercial bank refers to a bank, or a division of a large bank, which more specifically deals with deposit and loan services provided to corporations or large/ middle-sized business - as opposed to individual members of the public/small business

### Functions of Commercial Banks

- The functions of commercial banks are broadly classified into primary functions and secondary functions

## Primary Functions

**1. Accepting Deposits**

- It implies that commercial banks are mainly dependent on public deposits.

- There are two types of deposits, which are discussed as follows
    - **Demand Deposits:** It refers to deposits that can be withdrawn by individuals without any prior notice to the bank. In other words, the owners of these deposits are allowed to withdraw money anytime by writing a withdrawal slip or a cheque at the bank counter or from ATM centers using debit card.
    - **Time Deposits:** It refers to deposits that are made for certain committed period of time. Banks pay higher interest on time deposits. These deposits can be withdrawn only after a specific time period by providing a written notice to the bank.

2. **Advancing Loans**

- It refers to granting loans to individuals and businesses. Commercial banks grant loans in the form of overdraft, cash credit, and discounting bills of exchange.

## Secondary Functions

1. **Agency Functions**

- It implies that commercial banks act as agents of customers by performing various functions
    - **Collecting Cheques**: Banks collect cheques and bills of exchange on the behalf of their customers through clearing house facilities provided by the central bank.
    - **Collecting Income:** Commercial banks collect dividends, pension, salaries, rents, and interests on investments on behalf of their customers. A credit voucher is sent to customers for information when any income is collected by the bank.
    - **Paying Expenses:** Commercial banks make the payments of various obligations of customers, such as telephone bills, insurance premium, school fees, and rents. Similar to credit voucher, a debit voucher is sent to customers for information when expenses are paid by the bank.

2. **Transferring Funds**

- It refers to transferring of funds from one bank to another. Funds are transferred by means of draft, telephonic transfer, and electronic transfer.

3. **Letter of Credit**

- Commercial banks issue letters of credit to their customers to certify their creditworthiness.

- **Underwriting Securities:** Commercial banks also undertake the task of underwriting securities. As public has full faith in the creditworthiness of banks, public do not hesitate in buying the securities underwritten by banks.
- **Electronic Banking:** It includes services, such as debit cards, credit cards, and Internet banking.

3. **General Utility Functions**

- It implies that commercial banks provide some utility services to customers by performing various functions.
  - **Dealing in Foreign Exchange:** Commercial banks help in providing foreign exchange to businessmen dealing in exports and imports. However, commercial banks need to take the permission of the Central Bank for dealing in foreign exchange.
  - **Providing Locker Facilities:** Commercial banks provide locker facilities to its customers for safe custody of jewellery, shares, debentures, and other valuable items. This minimizes the risk of loss due to theft at homes. Banks are not responsible for the items in the lockers.

## Other Functions



1. **Money Supply**

- It refers to one of the important functions of commercial banks that help in increasing money supply

2. **Credit Creation**

- Credit Creation means the multiplication of loans and advances. Commercial banks receive deposits from the public and use these deposits to give loans. However, loans offered are many times more than the deposits received by banks. This function of banks is known as 'Credit Creation'.

## REGIONAL RURAL BANKS

- The Regional Rural Banks (RRBs) were first set up on 2 October, 1975 (only 5 in numbers)
- RRBs were established based on the recommendations of Narsimham Committee working group
- RRBs were set up as regional based rural lending institutions under the Regional Rural Banks Act, 1976.
- The Government of India, the concerned state government and the sponsoring nationalised bank contribute the share capital of the RRBs in the proportion of 50 per cent, 15 per cent and 35 per cent, respectively. The area of operation of the RRB is limited to notified few districts in a state.
- First RRB: Prathama Grameen Bank

- As per guidelines of Reserve Bank of India (RBI), the RRBs have to provide 75 per cent of their total credit under Priority Sector Lending(PSL)
- The main objective of the RRBs is to provide credit and other facilities particularly to the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs so as to develop agriculture, trade, commerce, industry and other productive activities in the rural areas.

## SMALL & PAYMENT BANKS

- In 2014, the RBI issued the draft guidelines for setting up small banks and payment banks. The guidelines said that both are 'niche' or 'differentiated' banks with the common objective of furthering financial inclusion

### Small finance banks

- Small finance banks are a type of niche banks in India. Banks with a small finance bank license can provide basic banking service of acceptance of deposits and lending. The aim behind these to provide financial inclusion to sections of the economy not being served by other banks, such as small business units, small and marginal farmers, micro and small industries and unorganized sector entities

### Payments Banks



- The objective of payments banks is to increase financial inclusion by providing small savings accounts, payment/remittance services to migrant labour, low income households, small businesses, other unorganized sector entities and other users by enabling high volume-low value transactions in deposits and payments/remittance services in a secured technology-driven environment.
- Payments Banks can accept demand deposits (only current account and savings accounts). They would initially be restricted to holding a maximum balance of 1 lakhs per customer. Based on performance, the RBI could enhance this limit.
- The Payments Banks would be required to use the word 'Payments' in its name to differentiate it from other banks.
- No credit lending is allowed for Payments Banks.
- Payments Banks Formation - Nachiket Mor Committee

## CO-OPERATIVE BANKS

- Banks in India can be broadly classified under two heads — commercial banks and co-operative banks. While commercial banks (nationalized banks, State Bank group, private sector banks, foreign banks and regional

rural banks) account for an overwhelming share of the banking business, cooperative banks also play an important role.

- It can be divided into 2 broad segments i) Urban Cooperative Banks ii) Rural Cooperative Banks

**Urban Cooperative Banks**

- Urban Cooperative Banks are scheduled and non-scheduled.
- Banking activities of Urban Cooperative Banks are monitored by RBI. Registration and Management activities are managed by Registrar of Cooperative Societies (RCS). These RCS operate in single-state and Central RCS (CRCS) operate in multiple state.

**Rural Cooperatives Banks**

- Rural cooperative Banks are short-term and long-term structures.
- The short-term co-operative credit structure operates with a three-tier system
  1. State Cooperative Banks: Operate at the apex level in states
  2. District Central Cooperative Banks: Operate at the district levels
  3. Primary Agricultural Credit Societies: Operate at the village or grass-root level



## MUDRA (Micro Units Development and Refinance Agency)

- Pradhan Mantri MUDRA Yojana (PMMY) is a scheme launched by the Hon'ble Prime Minister on April 8, 2015 for providing loans non-corporate, non-farm small/micro-enterprises.
- These loans are classified as MUDRA loans under PMMY. These loans are given by Commercial Banks, RRBs, Small Finance Banks, MFIs and NBFCs.
- The products designed under it are categorized into three buckets of finance named **Shishu** (loan up to ₹50,000), **Kishor** (₹50,000 to ₹5 lakh) and **Tarun** (₹5 lakh to ₹10 lakh).
- The scheme's objective is to refinance collateral-free loans given by the lenders to small borrowers
- Though the scheme covers the traders of fruits and vegetables, in general, it does not refinance the agriculture sector.

## (Non-Banking Financial Companies) NBFCs

- A non-bank financial company (NBFC) is a financial institution that does not have a full banking license or is not supervised by the central bank.

- NBFCs can be broadly classified into two categories. Viz.., (1) Stock Exchange; and (2) Other Financial institutions. Under the latter category comes Finance Companies, Finance Corporations, ChitFunds, Building Societies, Issue Houses, Investment Trusts and Unit Trusts and Insurance Companies.
- It is company under companies Act,1956
- It is engaged in the business of loans and advances, acquisition of bonds/debentures/securities issued by Government or local authority or other marketable securities, leasing, hire-purchase, insurance business, chit business but does not include any institution whose principal business is that of agriculture activity, industrial activity, purchase or sale of any goods or providing any services and sale or purchase of immovable property
- It cannot have demand deposits like current and saving accounts

## NABARD (A National Bank for Agriculture and Rural Development)

- NABARD was established on the recommendation of B.Sivaramman Committee on 12 July 1982
- NABARD set up in July 1982 by an Act of parliament to take over the functions of ARDC and the refinancing functions of RBI in relation to co-operative banks and RRBs
- NABARD is linked organically with the RBI by the latter contributing half of its share capital the other half being contributed by the Government of India.
- Deputy Governor of RBI is appointed as Chairman of NABARD.

## Functions of NABARD

- NABARD acts as a refinancing institution for all kinds of production and investment credit to agriculture, small-scale industries, cottage and village industries, handicrafts and rural crafts and real artisans and other allied economic activities with a view to promoting integrated rural development.
- It provides short-term, medium-term and long-term credits to state co-operative Banks (SCBs), RRBs, LDBs and other financial institutions approved by RBI
- NABARD has the responsibility of coordinating the activities of Central and State Governments, the NITI Aayog and other all India and State level institutions entrusted with the development of small scale industries, village and cottage industries, rural crafts, industries in the tiny and decentralized sectors, etc.
- It has the responsibility to inspect RRBs and co-operative banks, other than primary co-operative societies.
- It maintains a Research and Development Fund to promote research in agriculture and rural development

## Pradhan Mantri Jan-Dhan Yojana

- To achieve the objective of financial inclusion by extending financial services to the large hitherto unserved population of the country and to unlock its growth potential, the Pradhan Mantri Jan-Dhan Yojana (PMJDY) was launched on 28 August 2014.

# MONEY

- Monetary Economics is a branch of economics that provides a framework for analyzing money and its functions as a medium of exchange, store of value and unit of account.
- Money is anything that is generally accepted as payment for goods and services and repayment of debts and that serves as a medium of exchange.

## Evolution of Money

### Barter System

- The introduction of money as a medium of exchange was one of the greatest inventions of mankind. Before money was invented, exchange took place by Barter, that is, commodities and services were directly exchanged for other commodities and services.
- Goods like skins, salt, rice, wheat, utensils, weapons, etc. were commonly used as money. Such an exchange of goods for goods was known as "Barter System".
- Barter system was introduced by Mesopotamia tribes



### Metallic Standard

- Under the metallic standard, some kind of metal with gold or silver is used to determine the standard value of the money and currency. Their face value is equal to their intrinsic metal value.

### Gold Standard

- Gold Standard is a system in which the value of the monetary unit or the standard currency is directly linked with gold. The purchasing power of a unit of money is maintained equal to the value of a fixed weight of gold.

### Silver Standard

- The silver standard is a monetary system in which the standard economic unit of account is a fixed weight of silver

### Paper Currency Standard

- The paper currency standard refers to the monetary system in which the paper currency notes issued by the Treasury or the Central Bank or both circulate as unlimited legal tender. Its value is determined independent of the value of gold or any other commodity.
- The quantity of money in circulation is controlled by the monetary authority to maintain price stability.

**Plastic Money**

- The latest type of money is plastic money. Plastic money is one of the most evolved forms of financial products.
- Plastic money can come in many different forms such as Cash cards, Credit cards, Debit cards, Pre-paid Cash cards, Store cards, Forex cards and Smart cards

**Crypto Currency**

- A digital currency in which encryption techniques are used to regulate the generation of units of currency and verify the transfer of funds, operating independently of a Central Bank. Example: Bitcoin

**Important concepts**



**Barren Money**

- Money which is not earning any interest
- Money which is not invested anywhere
- Money which is kept in a safe deposit locker

**Fiat Money**

- Fiat money is one that is declared legal tender. This includes any form of currency in circulation such as paper money or coins. Fiat money is backed by a country's government instead of a physical commodity.

**Supply of Money**

- Money supply means the total amount of money in an economy. It refers to the amount of money which is in circulation in an economy at any given time.
- Money supply plays a crucial role in the determination of price level and interest rates
- In India, currency notes are issued by the Reserve Bank of India (RBI) and coins are issued by the Ministry of Finance, Government of India (GOI).
- Determinants of Money Supply
    1. Currency Deposit Ratio (CDR)

2. Reserve deposit Ratio (RDR)
3. Cash Reserve Ratio (CRR)
4. Statutory Liquidity Ratio (SLR)

# INFLATION AND BUSINESS CYCLE

## INFLATION

- Inflation is a consistent and appreciable rise in the general price level. In other words, inflation is the rate at which the general level of prices for goods and services is rising and consequently the purchasing power of currency is falling.
- The rate of inflation is measured on the basis of price indices which are of two kinds— Wholesale Price Index (WPI) and Consumer Price Index (CPI).

### Types of Inflation (Based on demand and supply)

**Demand-Pull Inflation**

- Demand and supply play a crucial role in deciding the inflation levels in the society at all points of time. For instance, if the demand is high for a product and supply is low, the price of the products increases



**Cost-Push Inflation:**

- When the cost of raw materials and other inputs raises inflation results. Increase in wages paid to labour also leads to inflation.

### Types of Inflation (On the basis of speed)

**Creeping Inflation or Low Inflation**

- Creeping inflation is slow-moving and very mild. The rise in prices will not be perceptible but spread over a long period.
- Low inflation or Creeping inflation takes place in a longer period and the range of increase is usually in 'single-digit'.
- This type of inflation is in no way dangerous to the economy. This is also known as mild inflation

**Walking Inflation:**

- When prices rise moderately and the annual inflation rate is a single digit ( 3% - 9%), it is called walking or trolling inflation.

**Running Inflation:**

- When prices rise rapidly like the running of a horse at a rate of speed of 10% - 20% per annum, it is called running inflation

**Galloping Inflation**

- This is a 'very high inflation' running in the range of double-digit or triple-digit (20%,100%,200 per cent in a year)

**Hyperinflation**

- This form of inflation is 'large and accelerating' which might have the annual rates in million or even trillion. In such inflation not only the range of increase is very large, but the increase takes place in a very short span of time, prices shoot up overnight.

## Types of inflation (on the basis of inducement)

**Credit inflation**

- When banks are liberal in lending credit, the money supply increases and thereby rising prices.

**Currency inflation**



- The excess supply of money in circulation causes rise in price level.
- This type of inflation is caused by the printing of currency notes

**Deficit induced inflation**

- The deficit budget is generally financed through printing of currency by the Central Banks. As a result, prices rise

**Tax induced inflation**

- Increase in indirect taxes like excise duty, custom duty, GST and sales tax may lead to rise in price (Ex. petrol and diesel). This is called **tax induced inflation.**

**Scarcity induced inflation**

- The scarcity of goods happen either due to a fall in production (Ex. farm goods) or due to hoarding and black marketing. This also pushes up the price.

**Profit induced inflation**

- When the firms aim at higher profit, they fix the price with a higher margin. So prices go up

## Causes of Inflation

The main causes of inflation are as follows:

**Increase in Money Supply**

- Inflation is caused by an increase in the supply of money which leads to increase in aggregate demand. The higher the growth rate of the nominal money supply, the higher is the rate of inflation.

**Increase in Consumer Spending:**

- The demand for goods and services increases when they are given credit to buy goods on hire-purchase and installment basis.

**Increase in Exports**

- When exports are encouraged, domestic supply of goods decline. So prices rise.

**Repayment of Public Debt**

- Whenever the government repays its past internal debt to the public, it leads to increase in the money supply with the public. This tends to raise the aggregate demand for goods and services.

**Deficit Financing**



- Deficit financing may lead to inflation.
- Deficit refers to the difference between expenditure and receipts. In public finance, it means the government is spending more than what it is earning. Due to deficit financing money supply increases & the purchasing power of the people also increase. This raises aggregate demand in relation to aggregate supply, thereby leading to an inflationary rise in prices.

**Cheap Money Policy**

- Cheap money policy means making money available to trade and industry at a cheaper interest rate
- Cheap money policy leads to an increase in the money supply which raises the demand for goods and services in the economy

**Increase in Disposable Income**

- Disposable Income is also known as Disposable personal income. It is the individual's income after the payment of income tax

  Disposable Income = Personal income – Direct Tax
- When the disposable income of the people increases, it raises their demand for goods and services.

**Black Assests, Activities and Money**

- The existence of black money and black assets due to corruption, tax evasion, etc., increases the aggregate demand. People spend such money, lavishly. Black marketing and hoarding reduce the supply of goods. These trends tend to raise the price level further

## Effects of Inflation

**On Debtors and Creditors:**

- During inflation, debtors are the gainers while the creditors are losers. The reason is that the debtors had borrowed when the purchasing power of money was high and now repay the loans when the purchasing power of money is low due to rising prices.
- The opposite effect takes place when inflation falls (i.e., deflation).

**On Employment**

- Inflation increases employment in the short-run, but becomes neutral or even negative in the long run

**On Import**

- Inflation gives an economy the advantage of lower imports and import substitution as foreign goods become costlier. But in the case of compulsory imports (i.e., oil, technology, drugs, etc.) the economy does not get this benefit and loses more foreign currency instead of saving it.
- Inflation increase exchange rates and makes all the imports costlier

**On Export**

- With inflation, exportable items of an economy gain competitive prices in the world market. Due to this, the volume of export increases, and thus export income increases in the economy.
- A high rate of inflation will hit hard the export industry in the economy. The cost of production will rise and the exports will become less competitive in the international market.
- Inflation can heavily impact the imports and exports of a country

**On Trade Balance**

- In the case of a developed economy, inflation makes trade balance favorable, while for the developing economies inflation is unfavorable for their balance of trade. This is because of composition of their foreign trade.
- If compulsory imports are more inflation act as a disadvantage

**Fixed-income Groups**

- The fixed incomes groups are the worst hit during inflation because their incomes being fixed do not bear any relationship with the rising cost of living. Examples are wage, salary, pension, interest, rent etc.

**Investors**

- The investors, who generally invest in fixed interest yielding bonds and securities, have much to lose during inflation. On the contrary those who invest in shares stand to gain by rich dividends and appreciation in value of shares.

**Effects on Production**

- When inflation is very moderate, it acts as an incentive to traders and producers. The profit due to rising prices encourages and induces business class to increase their investments in production, leading to generation of employment and income

**On Exchange Rate**

- The currency with the higher inflation rate then loses value and depreciates, while the currency with the lower inflation rate appreciates on the Forex market.

## Measures to Control Inflation



- Some of the important measures to control inflation are as follows:
  1. Monetary Measures
  2. Fiscal Measures
  3. Other Measures.

**Monetary Measures**

- The most important method of controlling inflation is monetary policy of the Central Bank of the country.
- They are (i) Increase in Bank rate (ii) Sale of Government Securities in the Open Market (iii) Higher Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) (iv) Consumer Credit Control and (v) Higher margin requirements (vi) Higher Repo Rate and Reverse Repo Rate.
- Monetary policy can only be helpful in controlling inflation due to demand-pull factors.

**Fiscal Measures**

- Fiscal policy is now recognized as an important instrument to tackle an inflationary situation.
- The major anti-inflationary fiscal measures are the following:
  1. Reduction of Government Expenditure

2. Public Borrowing
3. Enhancing taxation.
4. Surplus budgets
5. Increase in savings

**Other Measures**

1. To Increase Production→ One of the foremost measures to control inflation is to increase the production
2. Wage and Price Controls→ Wage and price controls help in controlling wages as the price increases

## OTHER IMPORTANT TERMS

**Deflation**

- The essential feature of deflation is falling prices, reduced money supply and unemployment. Though falling prices are desirable at the time of inflation, such a fall should not lead to the fall in the level of production and employment. But if prices fall from the level of full employment both income and employment will be adversely affected.

**Stagflation**



- Stagflation is a combination of stagnant economic growth, high unemployment and high inflation.

**Disinflation**

- Disinflation is the slowing down the rate of inflation by controlling the amount of credit available to consumers without causing more unemployment. Disinflation may be defined as the process of reversing inflation without creating unemployment or reducing output in the economy

## INFLATION IN INDIA

- India calculates its inflation on two price indices; these are
  1. The wholesale price index (WPI)
  2. The consumer price index (CPI).
- WPI is measured on a weekly basis. The first index of wholesale prices commenced in India for the week of January 10, 1942. The base year of WPI is revised periodically. The current WPI base year is 2011-12 based on the prices of 697 commodities.
- India has been measuring inflation at the consumer prices also besides at the wholesale prices. But in place of a single consumer price index, India managing with four different set of the CPIs due to the socio-economic

differentiations found among the consumers. These are: CPI-IW (Industrial Worker), CPI-UNME (Urban Non-Manual Employees), CPI-RL (Rural Labourers) and CPI-AL (Agricultural Labourers).

## BUSINESS CYCLE

- The economic activity in a capitalist economy will have its periodic ups and downs. The study of these ups and downs is called the study of Business cycle or Trade cycle or Industrial Fluctuation.

### Meaning of business Cycle

- A business cycle refers to oscillations in aggregate economic activity particularly in employment, output, income, etc. It is due to the inherent contraction and expansion of the elements which energize the economic activities of the nation. The fluctuations are periodical, differing in intensity and changing in its coverage.
- The four different phases of the business cycle are referred to as (i) Boom (ii) Recession (iii) Depression and (iv) Recovery

### Boom

- A strong upward fluctuation in the economic activities is called boom.
- The full employment and the movement of the economy beyond full employment are characterized as boom period. During this period, there is hectic activity in the economy. Money wages rise, profits increase and interest rates go up. The demand for bank credit increases and there is all-round optimism.



### Recession

- The turning point from boom condition is called recession. This happens at higher rate, than what was earlier. Generally, the failure of a company or bank bursts the boom and brings a phase of recession. Investments are drastically reduced, production comes down and income and profits decline. There is panic in the stock market and business activities show signs of dullness. Liquidity preference of the people rises and money market becomes tight.

### Depression

- During the depression, the level of economic activity becomes extremely low. Firms incur losses and closure of business becomes a common feature and the ultimate result is unemployment. Interest prices, profits and wages are low. The agricultural class and wage earners would be worst hit. Banking institutions will be reluctant to advance loans to businessmen.

- Depression is the worst phase of the business cycle. The extreme point of depression is called as “trough”, because it is a deep point in business cycle. Keynes advocated that autonomous investment of the government alone can help the economy to come out from the depression.

**Recovery**

- This is the turning point from depression to revival towards an upswing. It begins with the revival of demand for capital goods. Autonomous investments boost the activity. The demand slowly picks up and in due course the activity is directed towards the upswing with more production, profit, income, wages and employment. Recovery may be initiated by innovation or investment or by government expenditure

## ECONOMIC PLANNING IN INDIA

- Economic planning is a process under which attempts are made to achieve desired targets of economic development within a specified period of time
- After Independence of India, in 1948, a declaration of industrial policy was announced. The policy suggested the creation of a National Planning Commission and the elaboration of the policy of a mixed economic system



**The evolution of planning in India is stated below:**

- **Sir M. Vishveshwarya (1934):** a prominent engineer and politician made his first attempt in laying foundation for economic planning in India in 1934 through his book, “**Planned Economy of India**”. It was a 10 year plan.
- **Jawaharlal Nehru (1938):** set-up “**National Planning Commission**” by a committee but due to the changes in the political era and 2nd World War, it did not materialize.
- **Bombay Plan (1940):** The 8 leading industrialists of Bombay presented “Bombay Plan”. It was a 15 Year Investment Plan.
- **S. N Agarwal (1944)** gave the **“Gandhian Plan”** focusing on the agricultural and rural economy.
- **M.N. Roy (1945)** drafted **‘People’s Plan”.** It was aiming at mechanization of agricultural production and distribution by the state only.
- **J.P. Narayan (1950)** advocated, **“Sarvodaya Plan”** which was inspired by Gandhian Plan and with the idea of Vinoba Bhave. It gave importance not only for agriculture, but encouraged small and cottage industries in the plan.

## Planning Commission

- Planning Commission was set up to formulate Five Year Plan in India
- The Planning Commission was created on March 15, 1950, and the plan era began on April 1, 1951, with the launch of the first five-year plan (1951-56).
- Jawaharlal Nehru was the first Chairman of Planning Commission
- The Planning Commission has been replaced by the NITI Aayog on 1st January 2015.

## India's Five Year Plans

- The concept of economic planning in India or five year plan is derived from Russia
- India has launched 12 five year plans so far. The twelfth five-year plan was the last one in five-year plans
- The government of India has decided to stop the launching of five year plans and it was replaced by NITI Aayog.

## First Five Year Plan (1951-1956)

- This plan was based on the Harrod-Domar Model.
- Its main focus was on the agricultural development of the country.
- Many irrigation projects including Bhakra-Nangal Dam and Hirakud Dam were started in the first five-year plan.
- About 44.6 percent of the plan outlay went in favour of the public sector undertakings (PSUs).
- The community development projects were started
- This plan was successful and achieved the GDP growth rate of 3.6% (more than its target)



## Second Five Year Plan (1956-1961)

- It was based on the P.C. Mahalanobis Model.
- Its main focus was on the industrial development of the country. Second to transports and communication
- Steel plants at Bhilai, Durgapur, and Rourkela were established during this plan
- This plan was successful and achieved the growth rate of 4.1%.Due to the assumption of a closed economy, a shortage of food and capital were felt during this Plan.

## Third Five Year Plan (1961-1966)

- Third Five Year Plan is called 'Gadgil Yojna' also

- The main target of this plan was to make the economy independent and to reach self-propelled position or take off.
- The plan aimed to increase national income by 30 % and agriculture production by 30 %
- Due to Indo -China war, this plan could not achieve its growth target of 5.6%

### Plan Holiday or Three Annual (1966-1969)

- The main reason behind the plan holiday was the Indo-Pakistan war & failure of third plan.
- During this period, annual plans (1966-1967,1967-1968 & 1968-1969)were made and equal priority was given to agriculture, its allied sectors and the industry sector

### Fourth Five Year Plan (1969-1974)

- There are two main objectives of this plan i.e. growth with stability and Progressive achievement of self-reliance
- Fourteen Major Indian Banks were nationalised
- This plan failed and could achieve growth rate of 3.3% only, against the target of 5.7%.

### Fifth Five Year Plan (1974-1979)



- In this plan top priority was given to agriculture, next came industry and mines.
- The plan also focused on poverty alleviation and self-reliance
- The Twenty Point Programme (TPP) was launched by the Government of India in 1975. Prime Minister Indira Gandhi launched this programme.
- Overall this plan was successful, which achieved the growth rate of 4.8% against the target of 4.4%.
- The draft of this plan was prepared and launched by D.P. Dhar. This plan was terminated by Janata party government in 1978.

### Rolling Plan

- The Janta Government terminated the fifth five-year plan in 1977-78 and launched its own sixth five year plan for period 1978-83.
- In 1980, there was again a change of government at the Centre with the return of the Congress which abandoned the Sixth Plan of the Janata Government in the year 1980 itself.
- The new government launched a fresh new Sixth Plan for the period 1980–85.

- The plan (1978-1980) is called Rolling plan

## Sixth Five Year Plan (1980-1985)

- The basic objective of this plan was poverty eradication and technological self-reliance
- This Plan (1980–85) was launched with the slogan of **‘Garibi Hatao’**
- The plan gave emphasis on socio-economic infrastructure in the rural areas and also focused on eliminating rural poverty and regional disparities
- Its growth target was 5.2% but it achieved 5.7%.

## Seventh Five Year Plan (1985-1990)

- The Plan (1985- 90) emphasised on rapid food grain production, increased employment creation and productivity in general.
- The Jawahar Rozgar Yojana (JRY) was launched in 1989 with the motive to create wage employment for the rural poor.
- The plan also focused on growth, modernisation, self-reliance and social justice
- Its growth target was 5.0% but it achieved 6.0%.



## Two Annual Plans

- Eighth five year Plan could not take place due to volatile political situation at the centre. So two annual programmes are formed in 1990-91& 1991-92.
- The two consecutive Annual Plans (1990–92) were formulated within the framework of the approach to the Eighth Plan (1990–95) with the basic thrust on maximisation of employment and social transformation

## Eighth Five Year Plan (1992-1997)

- In this plan the top priority was given to development of the human resources i.e. employment, education and public health.
- During this plan, New Economic Policy of India was introduced.
- The Eighth Plan (1992–97) was launched in a typically new economic environment
- This plan was successful and got annual growth rate of 6.8% against the target of 5.6%.

## Ninth Five Year Plan (1997-2002)

- The main focus of this plan was “growth with justice and equity”. „

- This five-year plan gave priority to Agriculture and Rural Development with a view to generating adequate productive in employment and eradication of poverty
- Ensuring food and nutritional security for all
- The plan emphasizes seven minimum services which include Safe drinking water, Primary health service, Universalization of primary education, and Nutritional support to children.
- This plan failed to achieve the growth target of 7% and Indian economy grew only at the rate of 5.6%.

## Tenth Five Year Plan (2002-2007)

- This plan aimed to double the per capita income of India in the next 10 years.
- This five-year plan aims to achieve 8 percent average GDP growth for the period (2002-07)
- Reduction in gender gaps in literacy and wages rates by at least 50% by 2007
- It aimed to reduce the poverty ratio to 15% by 2012.
- Increased emphasis on the social sector (education, health, etc.)
- Its growth target was 8.0% but it achieved only 7.2%.



## Eleventh Five Year Plan (2007-2012)

- The Plan targets a growth rate of 10 percent and emphasizes the idea of 'faster and more inclusive growth'.
- Prepared by C.Rangarajan
- Its growth rate target was 8.1% but it achieved only 7.9%

## Twelfth Five Year Plan (2012-2017)

- Its main theme is "Faster, More Inclusive and Sustainable Growth".
- Provide electricity to all villages
- Connect all villages with all-weather roads
- Provide access to banking services to 90 percent Indian households
- Its growth rate target is 8%.

## NITI Aayog

- NITI Aayog (National Institution for Transforming India) was formed on January 1, 2015 through a Union Cabinet resolution. NITI Aayog is a policy **think-tank** of the Government of India
- The NITI Aayog is the new planning body replacing Planning Commission in India.

- NITI Aayog serves as a knowledge hub and monitors progress in the implementation of policies and programmes of the Government of India.
- The Prime Minister is the Chairperson of NITI Aayog and Union Ministers will be Ex-officio members. The Vice-Chairman is the functional head of NITI Aayog

**Structure of the NITI**

1. Chairman: the Prime Minister of India (ex-officio).
2. Governing Council: will comprise the Chief Ministers of all states and Lt. Governors of union territories.
3. Vice-Chairperson–to be appointed by the PM (First Vice Chairman was **Arvind Panangariya**).
4. Members: all as full-time.
5. Part-time Members: maximum of 2, from leading universities, research organisations and other relevant institutions in an ex-officio capacity.
6. Ex-Officio Members: maximum of 4 members of the Union Council of Ministers to be nominated by the PM.
7. Chief Executive Officer: to be appointed by the PM for a fixed tenure, in the rank of Secretary to the Government of India.



**Functions of NITI Aayog**

- **Cooperative and Competitive Federalism:** To enable the States to have active participation in the formulation of national policy.
- **Decentralized Planning:** To restructure the planning process into a bottom-up model.
- **Vision and Scenario Planning:** To design medium and long-term strategic frameworks towards India's future.
- **Internal Consultancy:** It provides internal consultancy to Central and State governments on policy and programmes.
- **Monitoring and Evaluation:** It will monitor the implementation of policies and progammes and evaluate the impacts.

## TAX STRUCTURE IN INDIA

- Tax is a compulsory payment by the citizens to the government to meet the public expenditure. It is legally imposed by the government on the taxpayer and in no case, taxpayers can refuse to pay taxes to the
  Example: Income tax, Corporate tax, Sales tax

- Modern economics defines tax as a mode of income redistribution.

### Direct Tax

- Direct tax is referred to as the tax, levied on person's income and wealth and is paid directly to the government.

  Example: Income tax, Corporate tax, etc.

### Indirect Tax

- Indirect Tax is referred to as the tax, levied on a person who consumes the goods and services and is paid indirectly to the government.

  Example: Sales Tax, Entertainment Tax, Service Tax etc.

### Methods of Taxation

- There are three methods of taxation prevalent in economies with their individual merits. These are
  1. Regressive taxation
  2. Proportional taxation
  3. Progressive taxation



### Progressive taxation

- A progressive tax is a tax that imposes a lower tax rate on low-income earners compared to those with a higher income, making it based on the taxpayer's ability to pay. That means it takes a larger percentage from high-income earners than it does from low income individuals.
- Indian income tax is a typical example of Progressive tax. The idea here is less tax on the people who earn less and higher taxes on the people who earn more
- This is the most popular taxation method in the world and a populist one, too

### Regressive taxation

- A regressive tax is a tax applied uniformly, taking a larger percentage of income from low-income earners than from high-income earners. It is in opposition to a progressive tax
- This method while appreciated for rewarding the higher producers or income earners is criticised for being more taxing on the poor and low-producers.

### Proportional taxation

- A proportional tax system also referred to as a flat tax system, assesses the same tax rate on everyone regardless of income or wealth.
- The sales tax is one of the best examples of proportional tax because all consumers regardless of income pay the same fixed rate

## TAXATION IN INDIA

- Article 256 of the constitution of India states that "No tax shall be levied or collected except by the authority of law". Hence, each and every tax that is collected needs to backed by an accompanying law.
- The taxation system in India is such that the taxes are levied and collected by the Central Government and the State Governments. Some minor taxes are also levied and collected by the local authorities such as the Municipality and the Local Governments.
- Major Central Taxes
  1. Income Tax
  2. Central Goods & Services Tax (CGST)
  3. Integrated Goods & Services Tax (IGST)
  4. Customs Duty
  5. Corporate tax
  6. Gift Tax
- Major State Taxes
  1. State Goods & Services Tax (SGST)
  2. Stamp Duty & Registration
  3. Professional tax
- Local Bodies Taxes
  1. Property tax
  2. Water tax
- The tax structure in India is divided into direct and indirect taxes



### Direct Taxes

- A direct tax is referred to as a tax levied on person's income and wealth and is paid directly to the government; the burden of such tax cannot be shifted.

- The tax is progressive in nature. It is levied according to the paying capacity of the person, i.e. the tax is collected more from the rich and less from the poor people
- The plans and policies of the Direct Taxes are being recommended by the Central Board of Direct Taxes (CBDT) which is under the Ministry of Finance, Government of India.
- Example: Income-tax, corporation tax, property tax and gift tax

**Merits of Direct Taxes**

- Direct taxes are progressive i.e. rate of tax varies according to tax base. For example, income tax satisfies the canon of equity.
- The cost of collection of direct taxes is relatively low. The tax payers pay the tax directly to the state.
- Direct taxes also satisfy the canon of elasticity. Income tax is income elastic in nature. As income level increases, the tax revenue to the Government also increases automatically
- Direct tax helps in controlling the inflation.

**Demerits of Direct Taxes**

- Direct tax adversely affects productivity. Citizens are not willing to earn more income because in that case they have to pay more taxes.
- The burden of direct tax is so heavy that tax payers always try to evade taxes. This leads to the generation of black money, which is harmful to the economy



## Indirect Tax

- Indirect Tax is referred to as a tax charged on a person who purchases the goods and services and it is paid indirectly to the government. The burden of tax can be easily shifted to another person. It is levied on all persons equally whether rich or poor. Example: GST, Customs Duty, etc.

**Merits of Indirect Taxes**

- All the consumers, whether they are rich or poor, have to pay indirect taxes. For this reason, it is said that indirect taxes can cover more people than direct taxes.
- The Government imposes indirect taxes on those commodities which are harmful to health e.g. tobacco, liquor etc. They are known as sin taxes.

**Demerits of Indirect Taxes**

- Indirect taxes are sometimes unjust and regressive in nature since both rich and poor persons have to pay same amount as taxes irrespective of their income level.
- Indirect taxes are less elastic compared to direct taxes. As indirect taxes are generally proportional.

## GST (Goods and Service Tax)

- GST is an Indirect Tax which has replaced many Indirect Taxes in India
- GST is one indirect tax for the entire country.
- The Goods and Service Tax Act was passed in the Parliament on 29th March 2017. The Act came into effect on 1st July 2017. The motto is one nation, one market, one tax.
- Goods & Services Tax in India is a comprehensive, multistage, destination-based tax that is levied on every value addition.
- GST is one of the biggest indirect tax reforms in the Country.

**Destination Based**

- GST is a destination-based tax

  Example: Consider goods manufactured in Telangana and are sold to the final consumer in Karnataka. Since Goods & Service Tax is levied at the point of consumption, in this case, Karnataka, the entire tax revenue will go to Karnataka and not Telangana.



**Components of GST**

- Components of GST The component of GST are of 3 types. They are: CGST, SGST & IGST.
  1. CGST: Collected by the Central Government on an intra-state sale (Eg: Within state/ union territory)
  2. SGST: Collected by the State Government on an intra-state sale (Eg: Within state/ union territory)
  3. IGST: Collected by the Central Government for inter-state sale (Eg: Maharashtra to Karnataka)

**The tax structure under the GST regime will be as follows**

| Transaction | New Regime | Old Regime | Remarks |
|---|---|---|---|
| Goods or services (Sale within the State) | CGST + SGST | VAT + Central Excise/Service tax | 1. Revenue will be shared equally between the Centre and the State |

| | | | |
|---|---|---|---|
| Goods or services (Sale to another State) | IGST | Central Sales Tax + Excise/Service Tax | 1. IGST tax is levied when there is an inter-state transfer of goods and services.<br>2. The Central Government will then share the IGST revenue based on the destination of goods |

**Other important Details**

- The GST is applicable on all goods and services other than following:
  1. Alcoholic liquor for human consumption
  2. Petroleum products (Petroleum crude, high-speed diesel, motor spirit, natural gas and aviation turbine fuel).
- Single Tax to replace multiple levies, right from manufacturer/supplier to consumer. GST incorporates many of the indirect taxes levied by states and the central government. The following is the list of indirect taxes in the pre-GST regime:
  1. State VAT/Sales Tax
  2. Central Sales Tax
  3. Purchase Tax
  4. Luxury Tax
  5. Entertainment and Amusement Tax
  6. Central Excise Duty
  7. Service Tax
  8. Additional Duties of Customs
  9. Additional Duties of Excise
  10. Taxes on advertisements

11. Taxes on lotteries, betting, and gambling

**Current GST Rates in India**

- Currently, the GST rate in India for various goods and services is divided under 7 slabs; these are 0% (Nil) GST, 0.25%GST, 3%GST,5% GST, 12% GST, 18% GST, and 28% GST

**Advantages of GST**

1. Removing cascading tax effect
2. Single point tax
3. Regulating the unorganized sector
4. Online simpler procedure under GST
5. Increased efficiency in logistics

## PUBLIC FINANCE IN INDIA

- Public finance is a study of the financial aspects of Government. It is a branch of economics which deals with government revenue and government expenditure
- Public finance gets the reference in the ancient treatise **Arthashastra** of **Kautilya** which covers 'treasury, sources of revenue, accounts and audit' in a very detailed way.



**Budget**

- The budget is an annual financial statement which shows the estimated income and expenditure of the Government for the forthcoming financial year.
- India is a federal economy; hence public budget is divided into two layers of the Government. According to the Indian Constitution, the Central Government has to submit annual financial statement, i.e., Union Budget under **Article 112** to the Parliament and each State Government has to submit the same for the State in the Legislative Assembly under **Article 202**.

- On the basis of expenditure on revenue account and other accounts, a budget can be presented in two ways:
  - **Revenue Budget:** It consists of revenue receipts and revenue expenditure. Moreover, the revenue receipts can be categorised into tax revenue and non-tax revenue. Revenue expenditure can also be categorised into plan revenue expenditure and non-plan revenue expenditure.
  - **Capital Budget:** It consists of capital receipts and capital expenditure. In this case, the main sources of capital receipts are loans, advances etc. On the other side capital expenditure can be categorised into plan capital expenditure and non-plan capital expenditure.

**Revenue Receipts**

- Revenue receipts are those receipts that do not lead to a claim on the government. They are therefore termed non-redeemable. They are divided into **tax and non-tax revenue**
- **Tax revenues**, an important component of revenue receipts. The types of taxes are
  1. Direct taxes -Personal income tax, Corporation tax, wealth tax, gift tax, etc.
  2. Indirect taxes-customs duties (taxes imposed on goods imported into and exported out of India), GST, etc.



- **Non-tax revenue** of the government mainly consists of interest receipts on account of loans by the central government, dividends and profits on investments made by the government, fees and other receipts for

services rendered by the government. Cash grants-in-aid from foreign countries and international organisations are also included.

### Revenue Expenditure

- Revenue Expenditure is expenditure incurred for purposes other than the creation of physical or financial assets of the government. It relates to those expenses incurred for the normal functioning of the government departments and various services, interest payments on debt incurred by the government, and grants given to state governments and other parties
- Budget documents classify total expenditure into plan and non-plan expenditure
- **Plan revenue expenditure** related to central Plans (the Five Year Plans) and central assistance for State and Union Territory plans.
- **Non-plan revenue expenditure**, the more important component of revenue expenditure, covers a vast range of general, economic and social services of the government. The main items of non-plan expenditure are interest payments, defence services, subsidies, salaries and pensions.

### Capital Receipts



- All non-revenue receipts of a government are known as capital receipts.
- The government receives money by way of loans or from the sale of its assets. Loans will have to be returned to the agencies from which they have been borrowed. Thus they create liability. Sale of government assets, like sale of shares in Public Sector Undertakings (PSUs) which is referred to as PSU disinvestment, reduce the total amount of financial assets of the government. All those receipts of the government which create liability or reduce financial assets are termed as capital receipts (Provident fund (PF), Postal Deposits, various small saving schemes and the government bonds sold to the public).

### Capital Expenditure

- There are expenditures of the government which result in creation of physical or financial assets or reduction in financial liabilities. This includes expenditure on the acquisition of land, building, machinery, equipment, investment in shares, and loans and advances by the central government to state and union territory governments, PSUs and other parties
- Capital expenditure is also categorised as plan and non-plan in the budget documents

- Plan capital expenditure, like its revenue counterpart, relates to central plan and central assistance for state and union territory plans.
- Non-plan capital expenditure covers various general, social and economic services provided by the government.

## Balanced, Surplus and Deficit Budget

### Balanced Budget

- The government may spend an amount equal to the revenue it collects. This is known as a **balanced budget.**

  **Government's estimated Revenue = Government's proposed Expenditure.**

### Surplus Budget

- The budget is a surplus budget when the estimated revenues of the year are greater than anticipated expenditures.

  **Government Estimated revenue > Estimated Government Expenditure**

### Deficit Budget

- Deficit budget is one where the estimated government expenditure is more than expected revenue.

  **Government estimated Revenue < Government proposed Expenditure.**

## Budgetary Deficits

- When a government spends more than it collects by way of revenue, it incurs a budget deficit
- In reference to the Indian Government budget, the budget deficit is of four major types.

  1. Revenue Deficit
  2. Budget Deficit
  3. Fiscal Deficit
  4. Primary Deficit

### Revenue Deficit

- The revenue deficit refers to the excess of government's revenue expenditure over revenue receipts

  **Revenue deficit = Revenue expenditure – Revenue receipts**

### Budget Deficit

- Budget deficit is the difference between total receipts and total expenditure (both revenue and capital)

  **Budget Deficit = Total Expenditure – Total Revenue**

## Primary Deficit

- Primary deficit is equal to fiscal deficit minus interest payments.
- It shows the real burden of the government and it does not include the interest burden on loans taken in the past.

**Primary Deficit (PD) = Fiscal deficit (PD) - Interest Payment (IP)**

## Fiscal Deficit

- Fiscal deficit is the difference between the government's total expenditure and its total receipts excluding borrowing

## Fiscal policy

- **Fiscal policy** has been defined as the 'the policy of the government with regard to the level of government purchases, the level of transfers, and the tax structure'
- Fiscal policy is also defined as 'changes in government expenditures and taxes that are designed to achieve macroeconomic policy goals'
- As an instrument of macro-economic policy, fiscal policy has been very popular among modern governments. The growing importance of fiscal policy was due to the Great Depression and the development of 'New Economics' by Keynes.



## Fiscal Instruments

- Fiscal Policy is implemented through fiscal instruments also called 'fiscal tools' or fiscal levers: Government expenditure, taxation and borrowing are the fiscal tools.
    1. **Taxation**: Taxes transfer income from the people to the Government. Taxes are either direct or indirect. An increase in tax reduces disposable income. So taxation should be raised to control inflation. During depression, taxes are to be reduced.
    2. **Public Expenditure:** Public expenditure raises wages and salaries of the employees and thereby the aggregate demand for goods and services. Hence public expenditure is raised to fight recession and reduced to control inflation.
    3. **Public debt:** When Government borrows by floating a loan, there is transfer of funds from the public to the Government. At the time of interest payment and repayment of public debt, funds are transferred from Government to public.

## Objectives of Fiscal Policy

1. Full Employment
2. Price stability
3. Economic growth
4. Equitable distribution
5. External stability
6. Capital formation
7. Regional balance

## Finance Commission

- Finance commission is a quasijudicial body set up under Article 280 of the Indian Constitution. It was established in the year 1951, to define the fiscal relationship framework between the Centre and the state.
- Under Article 280 of the Constitution the finance commission to recommend the distribution of the net proceeds of taxes between the Centre and the states every five years.
- Finance Commission aims to reduce the fiscal imbalances between the centre and the states and also between the states. It promotes inclusiveness.
- A Finance Commission is set up once in every 5 years. It is normally constituted two years before the period.
- The 15th Finance Commission has been set up in November 2017.
- Chairman of 15th finance commission -N. K. Singh



# EXTERNAL SECTOR IN INDIA

- All economic activities of an economy which take place in foreign currency fall in the external sector such as export, import, foreign investment, external debt, the balance of payment, current account, capital account, etc

## TRADE

- Trade is one of the powerful forces of economic integration. The term 'trade' means exchange of goods, wares or merchandise among people.

## THE BALANCE OF PAYMENTS

- The Balance Of Payments (BoP) records the transactions in goods, services and assets between residents of a country with the rest of the world for a specified time period typically a year. Basically, it is the net outcome of the current and capital accounts of an economy
- There are two main accounts in the Balance Of Payments (BoP) — **the current account** and **the capital account.**

## CURRENT ACCOUNT

- Current Account is the record of trade in goods and services and transfer payments.
- It includes all international trade transactions of goods and services, international service transactions (i.e. tourism, transportation and royalty fees) and international unilateral transfers (i.e. gifts and foreign aid).

- **Trade in goods** includes exports and imports of goods

- **Trade in services** includes factor income and non-factor income transactions
- **Transfer payments** are the receipts which the residents of a country get for 'free', without having to provide any goods or services in return. They consist of gifts, remittances and grants. They could be given by the government or by private citizens living abroad.

## Balance on Current Account

- Current Account is in balance when receipts on current account are equal to the payments on the current account.

  1. **Receipts = Payments (Balanced Current Account)**

- A surplus current account means that the nation is a lender to other countries and a deficit current account means that the nation is a borrower from other countries.

  1. **Receipts > Payments (Current Account Surplus)**
  2. **Receipts < Payments (Current Account Deficit)**



- Balance on Current Account has two components:
  1. Balance of Trade or Trade Balance
  2. Balance on Invisibles

## Balance of Trade (BOT)

- It is the difference between the value of exports and the value of imports of goods of a country in a given period of time.
- Export of goods is entered as a credit item in Balance of Trade (BOT), whereas import of goods is entered as a debit item in Balance of Trade (BOT). It is also known as Trade Balance.
- **Balance of Trade** (BOT) is said to be in balance when exports of goods are **equal** to the imports of goods. Surplus BOT or Trade surplus will arise if country exports more goods than what it imports. Whereas, Deficit BOT or Trade deficit will arise if a country imports more goods than what it exports.

## Balance on Invisibles

- Net Invisibles is the difference between the value of exports and value of imports of invisibles of a country in a given period of time.
- Invisibles include services, transfers and flows of income that take place between different countries.
- Services trade includes both factor and non-factor income. Factor income includes net international earnings on factors of production (like land, labour and capital). Non-factor income is net sale of service products like shipping, banking, tourism, software services, etc.

## Capital Account

- Financial transactions consisting of direct investment and purchases of interest-bearing financial instruments, non-interest bearing demand deposits and gold fall under the capital account



- Capital Account records all international transactions of assets. An asset is any one of the forms in which wealth can be held, for example, money, stocks, bonds, Government debt, etc.

### Balance on Capital Account

- Capital account is in balance when capital inflows (like receipt of loans from abroad, sale of assets or shares in foreign companies) are equal to capital outflows (like repayment of loans, purchase of assets or shares in foreign countries).
- Surplus in capital account arises when capital inflows are **greater** than capital outflows, whereas deficit in capital account arises when capital inflows are **lesser** than capital outflows.

### Balance of Payments Disequilibrium

- The BoP is said to be balanced when the receipts (R) and payments (P) are just equal **R / P =1**
- Favorable BoP: When receipts exceed payments, the BoP is said to be favorable. That is,

**R / P > 1**

Unfavorable BOP: When receipts are less than payments, the BoP is said to be unfavorable or adverse. That is **R / P < 1**

## EXCHANGE RATE

### Definition of FOREX

- FOREX is the system or process of converting one national currency into another, and of transferring money from one country to another.

### FOREX Reserves

- The total foreign currencies (of different countries) an economy possesses at a point of time is its 'foreign currency assets/reserves'.
- The FOREX Reserves of an economy is its 'foreign currency assets' added with its gold reserves, SDRs (Special Drawing Rights) and Reserve Tranche Position (RTP) in the IMF



### Foreign exchange market

- The market in which national currencies are traded for one another is known as the foreign exchange market.
- The major participants in the foreign exchange market are commercial banks, foreign exchange brokers and other authorised dealers and monetary authorities.

### Rate of Exchange

- The price of one currency in terms of another currency is known as the foreign exchange rate or simply the exchange rate.
- The transactions in the exchange market are carried out at exchange rates. It is the external value of domestic currency. Thus, exchange rate may be defined as the price paid in the home currency (say ₹ 72) for a unit of foreign currency (say 1 US $).

## Types of Exchange Rate Systems

- There are two major exchange rate systems, namely,
  (1) Fixed (or pegged) exchange rate system and
  (2) Flexible (or floating) exchange rate system.
- Managed Floating Exchange Rate system also prevails in some countries (Example: India)

**Fixed Exchange Rates**

- Countries following the fixed exchange rate (also known as stable exchange rate and pegged exchange rate) system agree to keep their currencies at a fixed rate as determined by the Government. Under the gold standard, the value of currencies was fixed in terms of gold.

**Flexible Exchange Rates**

- Under the flexible exchange rate (also known as floating exchange rate) system, exchange rates are freely determined in an open market by market forces of demand and supply



**Determinants of Exchange Rates**

1. Differentials in Inflation
   - Inflation and exchange rates are inversely related. A country with a consistently lower inflation rate exhibits a rising currency value, as its purchasing power increases relative to other currencies
2. Public Debt
   - Large public debts are driving out foreign investors, because it leads to inflation. As a result, exchange rate will be lower.
3. Current Account Deficits

- A deficit in the current account implies excess of payments over receipts. The country resorts to borrowing capital from foreign sources to make up the deficit. Excess demand for foreign currency lowers a country's exchange rate

4. Recession

- Interest rates are low during the recession phase. This will decrease inflow of foreign capital. As a result, a currency will be depreciated against other currencies, thereby lowering the exchange rate.

## APPRECIATION

- An appreciation means an increase in the value of a currency against other foreign currency.
- An appreciation makes exports more expensive and imports cheaper.

## DEPRECIATION



- In foreign exchange market, it is a situation when domestic currency loses its value in front of a foreign currency if it is market-driven.
- It means depreciation in a currency can only take place if the economy follows the floating exchange rate system.

## DEVALUATION

- In the foreign exchange market when exchange rate of a domestic currency is cut down by its government against any foreign currency, it is called devaluation. It means official depreciation is devaluation.

## REVALUATION

- A term used in foreign exchange market which means a government increasing the exchange rate of its currency against any foreign currency. It is official appreciation.

## Important Terms

## SOFT CURRENCY

- A term used in the foreign exchange market which denotes the currency that is easily available in any economy in its FOREX market. For example, rupee is a soft currency in the Indian FOREX market.

## HARD CURRENCY

- Hard currency, safe-haven currency or strong currency is any globally traded currency that serves as a reliable and stable store of value.
- The strongest currency of the world is one which has a high level of liquidity.
- Some of the best hard currencies of the world today are the US Dollar, the Euro(€), Japanese Yen (¥) and the UK Sterling Pound (£).

## CHEAP CURRENCY

- The term was first used by the economist J. M. Keynes (1930s).
- If a government starts re-purchasing its bonds before their maturities (at full-maturity prices) the money which flows into the economy is known as the cheap currency, also called cheap money.
- In the banking industry, it means a period of comparatively lower/softer interest rates regime

## HOT CURRENCY

- Hot currency is a term of the FOREX market and is a temporary name for any hard currency
- When any hard currency is exiting from any economy at a fast pace, at the time that hard currency is said as hot currency

## HEATED CURRENCY

- A term used in the FOREX market to denote the domestic currency which is under pressure of depreciation due to a hard currency high tendency of exiting the economy. It is also known as currency under heat or under hammering.

## DEAR CURRENCY

- When a government issues bonds, the money which flows from the public to the government or the money in the economy in general is called dear currency, also called as dear money.
- In the banking industry, it means a period of comparatively higher/costlier interest rates regime

## Foreign Direct Investment (FDI)

- FDI is an important factor in global economy. Foreign trade and FDI are closely related.
- **FDI** means an investment in a foreign country that involves some degree of control and participation in management. It corresponds to the investment made by a multinational enterprise in a foreign country. It is different from portfolio investment, which is primarily motivated by short term profit and it does not seek management control.
- **Foreign Portfolio Investment (FPI)** means the entry of funds into a nation where foreigners deposit money in a nation's bank or make purchase in the stock and bond markets, sometimes for speculation. FPI is part of the capital account of BoP.
- **Foreign Institutional Investment (FII)** is an investment in hedge funds, insurance companies, pension funds and mutual funds. Foreign institutional investment is a common term in the financial sector of India

## FDI in India

- In India, FDI has been advantageous in terms of free flow of capital, improved technology, management expertise and access to international markets.
- FDI in India is allowed under Automatic Route. does not require prior approval either by the government of India/Reserve Bank of India

- The major sectors benefited from FDI in India are financial sector (banking and non-banking), insurance, telecommunication, hospitality and tourism, pharmaceuticals and software and information technology.
- Following sectors are prohibited for FDI
  1. Lottery Business
  2. Gambling and betting
  3. **The business** of chit fund
  4. Nidhi Company
  5. Trading in transferable development rights (TDRs)
  6. Atomic Energy

## HUMAN DEVELOPMENT IN INDIA

### HUMAN DEVELOPMENT INDEX



- United Nations Development Programme has been publishing Human Development Report annually since 1990. HDI helped the government to the real uplifting of standard of living of the people.
- HDI was developed by the Pakistani Economist **Mahbub ul Haq** and the Indian Economist **Amartya Sen** in 1990 and was published by the United Nations Development Programme (UNDP).
- HDI is constructed based on **Life Expectancy Index, Education Index and GDP Per Capita**
- HDI is based on the following three indicators
  1. Longevity is measured by life expectancy at birth
  2. Educational attainments
  3. Standard of living, measured by real GDP per capita

Dimension Index = (Actual value – Minimum value) / (Maximum value - Minimum value)

- The performance in each dimension is expressed as a value between 0 and 1 by applying the following formula

- As per latest Human Development Report (2019) by the United Nations Development Programme (UNDP), India has been ranked 129st out of 189 countries. Out of 189 countries, India lies in Medium Human Development bracket
- Top three countries of HDI
  1. Norway (0.954)
  2. Switzerland (0.946)
  3. Ireland (0.942)
- In the Gender Inequality Index (GII), India is ranked 122 out of 162 countries. India's neighbor's China (39), Sri Lanka (86), Bhutan (99), Myanmar (106) were placed above India in the Index

### Promoting Inclusive Growth

- The focus of the Indian development planning has been on the formulation of programmes and policies aimed at bringing the 'marginalised and poor sections' of society into the mainstream.
- The Pradhan Mantri Jan Dhan Yojna (PMJDY) launched in August 2014 and the RuPay Card, are important schemes for financial inclusion. These two schemes are complementary and will enable the achievement of multiple objectives such as financial inclusion, insurance penetration, and digitalisation.
- The Government of India has always given priority to employment generation and employability improvement. Various steps have been taken for 'generating employment' in the country like encouraging private sector of the economy, fast-tracking various projects involving substantial investment and increasing public expenditure on schemes such as Prime Minister's Employment Generation Programme (PMEGP), Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS), Pt. Deen Dayal Upadhyaya Grameen Kaushalya Yojana (DDU-GKY) and Deendayal Antodaya Yojana-National Urban Livelihoods Mission (DAY-NULM).



## IMPORTANT TERMS IN ECONOMY

1. **Per Capita Income:** Average national income per head of population. It is obtained by dividing the National Income by population size.
2. **Gross Domestic Product:** Total monetary value of the goods and services produced by that country over a specific period of time, normally a year

3. **GNP :**Total money value of final goods and services produced in a country during a particular year (one year) including depreciation and net exports
4. **NNP:** Total money value of final goods and services produced in a country during a particular year (one year) excluding depreciation including net exports
5. **NNP at Factor cost :**The total of income payment made to factors of production
6. **Personal Income:** Total income received by the individuals of a country before payment of direct taxes
7. **Economic Growth:** Transformation of an economy from a state of under development to a state of development which is measured by Gross Domestic Product
8. **Nationalisation:** The process of transforming private assets ownership into government ownership.
9. **Human Development Index:** It is a composite statistic of life expectancy education and per capita income indicators.
10. **Foreign Direct Investment:** An investment in a business by an investor from another country.
11. **SLR**: Statutory Liquidity Ratio refers to the amount that the commercial banks require to maintain in the form of cash or gold or government approved securities before providing credit to the customers



12. **SEZ**: It is an area in which business and trade laws are different from rest of the country mainly aiming at increasing trade, investment and job creation
13. **Globalization**: Globalization stands for the consolidation of the various economies of the world.
14. **Unemployment**: When there are people, who are willing to work and able to work but cannot find suitable jobs.
15. **Open Unemployment** :Unemployed persons are identified as they remain without work
16. **Seasonal Unemployment:** Employment occurs only in a particular season and workers remain unemployed in the remaining period of a year.
17. **Full employment:** Persons who are willing to work and able to work must have employment or a job
18. **Poverty**: Condition where the basic needs of the people like food, clothing and shelter are not being met.
19. **Liberalization**: Liberalization refers to the relaxation of the government restriction usually in the area of social and economic policies.
20. **Value**: Power of a commodity to command other commodities in an exchange
21. **Price**: Value of a commodity expressed in terms of money

22. **Consumption**: The use of goods and services for satisfying one's wants.
23. **Macroeconomics** : The branch of economics that studies the behavior and performance of an economy as a whole
24. **Microeconomics**: The part of economics concerned with single factors and the effects of individual decisions.
25. **Economic System**: The manner in which individuals and institutions are connected together to carry out economic activities in a particular area
26. **Capitalism**: The system where the means of production are privately owned and market determines the economic activities
27. **Socialism**: A way of organizing a society in which major economic activities are owned and controlled by the government rather than by individual people and companies
28. **Mixedism**: An ideology that mixes or combines the principles of Capitalism (Private Role) and Socialism (Nation Role) in an economy.
29. **Money**: An asset that is generally acceptable as a medium of exchange
30. **Supply of Money:** It refers to the amount of money which is in circulation in an economy at any given time
31. **Inflation** :An increase in average level of prices
32. **Deflation**: A fall in average level of prices, the opposite of inflation
33. **Disinflation**: Process of reversing inflation without generating adverse effects.
34. **Stagflation**: The co-existence of a high rate of unemployment and inflation.
35. **Credit Creation:** It means the multiplication of loans and advances. Commercial banks receive deposits from the public and use these deposits to give loans.
36. **Bank Rate:** It is the rate at which the Central Bank of a country is prepared to re-discount the first class securities
37. **Statutory Liquidity Ratio (SLR):** It is the amount which a bank has to maintain in the form of cash, gold or approved securities.
38. **Cash Reserve Ratio (CRR):** Banks are required to hold a certain proportion of their deposits in the form of cash with RBI. This is known as CRR.
39. **Monetary Policy:** It is the macro-economic policy laid down by the Central Bank towards the management of money supply and interest rate.

40. **Capital Market:** It is a financial market in which long-term debt or equity backed securities are bought and sold.
41. **Demonetisation:** It is the act of stripping a currency unit of its status as legal tender. It occurs whenever there is a change of national currency
42. **Balance of Trade:** The balance between the values of goods exchanged between two countries. It is a trade in merchandise items or visible items only
43. **Balance of Payments:** The balance between the values of goods and services exchanged between two countries. It is a trade in both visible and non-visible items.
44. **Devaluation:** It means official reduction in the value of a currency in terms of gold or other currencies.
45. **Purchasing power** : Purchasing power is the value of a currency expressed in terms of the amount of goods or services that one unit of money can buy
46. **Foreign Exchange:** The currency of another country.
47. **Exchange Rate:** The rate at which one currency is exchanged for another currency.
48. **Fixed Exchange Rates:** An exchange rate that is held within a narrow band by the monetary authorities.
49. **Flexible Exchange Rates:** Flexible exchange rates are freely determined in an open market primarily by private dealings, and they, like other market prices, vary from day by day.
50. **Foreign Direct Investment:** The investment made by a multinational enterprise in a foreign country and an investment in a foreign country that involves some degree of control and participation in management
51. **Special Drawing Rights:** International monetary reserve currency created by the International Monetary Fund (IMF) that operates as a supplement to the existing money reserves of member countries.
52. **Free Trade Area:** A region encompassing a trade bloc whose member countries have signed a free-trade agreement (FTA). Such agreements involve cooperation between at least two countries to reduce trade barriers.
53. **Proportional Tax:** Tax is imposed at the same rate irrespective of tax base
54. **Progressive Tax:** The rate of tax increases with the increase in tax base (income)
55. **Regressive Tax:** High rate of tax is levied on the poor and low rate is levied to the rich
56. **Internal public debt:** A loan taken by the Government from the citizens or from different institutions with in the country

57. **External public debt:** A loan is taken from abroad or from an international organisation
58. **Fiscal Policy**: Policy related with the revenue and expenditure process of the Government
59. **Public expenditure :**The expenditure incurred by public authorities like central, state and local governments to satisfy the collective social wants of the people is known as public expenditure
60. **Budget**: It is an annual financial statement which shows the income and expenditure of the Government
61. **Balanced budget**: The government may spend an amount equal to the revenue it collects. This is known as a **balanced budget.**
62. **Deficit Budget:** The gap between Government anticipated revenue and the targeted expenditure
63. **Surplus budget**: The budget is a surplus budget when the estimated revenues of the year are greater than anticipated expenditures.
64. **Zero based budgeting:** Zero-based budgeting is a budgeting that allocates funding based on efficiency and necessity rather than on budget history. It is a method of budgeting in which all expenses must be justified and approved for each new period.
65. **Call money/ Notice money:** The money that is lent for **one day** in this market is known as **call money** and, if it exceeds one day, is referred to as **notice money.** Notice Money refers to the borrowing and lending of funds for **2-14 days**

66. **Direct Tax**: Direct tax is referred to as the tax, levied on person's income and wealth and is paid directly to the government.
67. **Indirect Tax:** Indirect Tax is referred to as the tax, levied on a person who consumes the goods and services and is paid indirectly to the government.
68. **Laissez-faire :** Laissez-faire economics is a theory that restricts government intervention in the economy
69. **Tobin Tax:** Tax on international flow of short term capital currency transactions. Burden of tax is inversely proportional to the length of transaction

## ECONOMY ONE LINER

- The Banking Regulation Act was passed in India in 1949.
- Adam Smith is called the father of modern Economics
- The SLR is determined by the RBI. SLR stands for Statutory Liquidity Ratio

- The base financial year for the calculation of the all India Index of Industrial Production (IIP) is 2011-12 sinceMay 2017.
- The agricultural sector is the largest employer in the Indian economy. However, this sector accounts for onlyabout 17% of India's GDP.
- An economic condition when there is one buyer and many sellers is called Monopsony
- A fiscal deficit occurs when a government's total expenditures exceed the total revenue that itgenerates, excluding money from borrowings
- An increase in price will decrease consumer surplus
- A situation where the expenditure of the government exceeds its revenue is called Budget Deficit
- Theory of opportunity cost is given by **Gottfried Haberler**.
- When the output is equal to zero, the variable cost is zero. A variable cost is a corporate expense that changesin proportion to production output.
- A substantial increase in capital expenditure or revenue deficit leads to Fiscal Deficit
- The Khadi and village Industries Commission Act was passed in the year 1956
- The Micro, Small and Medium Enterprises Development Act was passed in the year 2006
- Union Budget of India is presented by the Finance Minister of India in Lok Sabha of the Parliament
- Micro-economics is also called Price theory
- Hire and Fire is a policy of capitalist economy
- A closed economy is one that has no trading activity with outside economies
- Gender Budget Statement (GBS) was first introduced in the Indian Budget in 2005-06.
- The symbol of Indian rupee has been prepared by Udaya Kumar
- Economic survey is prepared by the Ministry of Finance
- The two main indicators of inflation in India are the wholesale price index and the consumer price index.
- The national income estimation is the responsibility of **Central Statistical Organisation (CSO)**
- The new GDP series calculates GDP based on **Market price**
- First Five-Year Plan was based on the **Harrod–Domar model**
- Indian income tax is **Direct and progress**

- **Software industry** is not affected by seasonal unemployment
- RTGS full form is **Real Time Gross Settlement**
- **Foreign direct investment** is full form of FDI
- Rate of growth of an economy is measured in terms of **National income**
- **France** was the first country to implement the GST in 1954
- **DD** is called a banker cheque
- Balance Sheet show the assets and liabilities which includes real account and personal account.
- 'Capital and growth' written by **John Richard Hicks**
- **GDP** is an indicator of the financial health of a country
- Prime Minister Narendra Modi launched GST into operation on the midnight of 1 July 2017
- New Economic Policy of India was announced in the year 1991
- One Rupee note bears the signature of the Finance Secretary of India
- Third five year plan is also known as "Gadgil Yojana"
- In India, Fiscal Policy is formulated by the Ministry of Finance.
- Export-Import bank of India was established in 1982
- Small Industries Development Bank of India (SIDBI), set up on April 2, 1990
- The central banking functions in India are performed by the Reserve Bank of India
- Income inequality is the major determinant of poverty both in developed and non-developed countries
- GATT was the earlier name of the WTO
- A Golden Handshake Scheme is associated with voluntary retirement
- The International Monetary Fund (IMF) is an organization of 189 countries
- The objective of self-reliance and zero net foreign aid was declared in the Fourth Five year plan
- Brent Index is associated with the price levels of light Crude oil
- On July 12, 1982, the ARDC was merged into NABARD
- The second Five Year plan was based on Mahalanobis model
- Short-term finance is usually for a period ranging up to 12 months
- 'Planned economy for India' was a book written by M. Visvesvaraya